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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

No. 600

HARRY E. HALLENBECK, Receiver of SOUTH ASHLAND NATIONAL BANK,

Petitioner,

vs.

W. F. LEIMERT, Receiver of CENTRAL MANUFACTURING DISTRICT BANK,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

DANIEL M. HEALY,
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OPPOSING BRIEF AND ARGUMENT.

I.

By proper endorsements all the checks were made payable to bearer. When the Central Bank got the checks it became the holder. It derived title to the checks through holders in due course. Thereby the Central Bank acquired all the rights of such prior holders.

Section 9, Subsection 5 of Negotiable Instrument Act, also Sections 58 and 190.

(Cahill Illinois Revised Statutes, 1933, Chap. 98.)

Section 9, Subsection 5, provides that an instrument is payable to bearer "when although originally payable to order, it is endorsed in blank by the payee or a subsequent endorsee."

Four of the checks were endorsed by the Ashland Bank, which, in turn, endorsed them payable to the order of any bank or banker. The other check was endorsed by the Ashland Bank payable to First National Bank, which endorsed it in blank.

Section 58 provides that:

> "In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But the holder who derives his title through a holder in due course, and who is not himself a party to any fraud or duress or illegality affecting the instrument, has all the rights of such former holder in respect to all parties prior to such holder."

Section 190 defines a *Holder* as:

> "The payee or endorsee of a bill or note, who is in possession of it, or the bearer thereof."

The Federal Reserve Bank and the First National Bank were holders in due course. They endorsed the checks in blank thereby making them payable to bearer. Central Bank became the holder and derived title through holders in due course, and consequently succeeded to all their rights.

II.

Neither the settlement by the Central Bank of its Clearing House balance nor the exchange of credits on the books of the First National Bank constituted payment by the Central Bank of any of the checks in question.

Brady on Bank Checks (2nd Ed.) 502.
Schneider v. *Bank of Italy*, 194 Pac. 1021 (Cal.).
Columbia-K. Trust Co. v. *Miller*, 215 N. Y. 191.
Hentz v. *National City Bank*, 144 N. Y. 979.
5 Michie on Banks & Banking, 575.

The fact that the Central Bank gave its check in settlement of the Clearing House balance, and that four of the checks in question, were among those which went to make up this balance, does not constitute payment. After making such settlement, the Central Bank had the right to a reasonable opportunity to examine the checks and the accounts on which they were drawn, and dishonor the checks that were not supported by the account on which they were drawn.

The Circuit Court of Appeals properly held this to be so and that the check given by the Central Bank in settlement of the Clearing House balance did not constitute final payment.

In

Columbia-Knickerbocker Trust Company, 215 N. Y. 191,

in discussing the question of whether or not the settlement of a clearing house balance constituted payment of any particular check, the court said:

> "Doubtless, the adjustment of balances by the Clearing House constitutes a sort of tentative or provisional payment, but that adjustment occurs without an oppor-

tunity to the members to examine the items, verify signatures, compare the amounts with the drawers' accounts, and the like, and regardless of whether the checks are good. The constitution of the association contemplates that the members will directly adjust between themselves claims arising from the return of checks. It thus appears that the question of payment is not, and cannot be, ultimately decided until the bank upon which the check is drawn has had an opportunity at its banking house to examine the checks."

In the same decision the Court also said:

"Concededly, the adjustment of the accounts at the Clearing House is, at most, tentative and provisional, and subject to an examination by each member of the checks drawn upon it."

The other authorities cited above are to the same effect. Counsel, practically, concede this but claim that the Central Bank, having elected to dishonor the checks, should have notified the Clearing House by 2:30 o'clock in the afternoon on the same day in accordance with its rules; that it did not give such notice, and, therefore, that the payment became unconditional and irrevocable after 2:30 o'clock in the afternoon.

The answer is given by the Circuit Court of Appeals and by the authorities cited under the next heading to-wit: The Ashland Bank was not a member of the Clearing House and, therefore, was not affected by them.

III.

The rules of the Clearing House are binding upon and for the benefit of its members alone and non-members cannot claim the benefit thereof.

1 Morse on Banks and Banking, (6th Ed.) 810.

National Ex. Bank v. *Ginn & Co.*, 114 Md. 181.

Merchants Nat'l Bank v. *National Bank of the Commonwealth*, 139 Mass. 518.

Brady on Bank Checks, (2nd Ed.) 503.

8 Michie on Bank & Banking, 165.

In

1 Morse on Banks and Banking, (6th Ed.), page 810,

it is said:

"The By-laws, rules and usages are binding upon members of the association. No outside bank is under any degree of obligation to observe them. But, on the other hand, no outside bank can have any remedy against any member of the association for a breach of them. They are in the nature of a contract to which the outsider is no party. The duty of adhering to them runs from each of the members to each and all the rest, but to no other person or corporation; at least unless any special and peculiar course of dealing between any member and any outside individual has operated to place that member under an express and exceptional obligation to the outsider to adhere in all matters in which he is interested to the regulations of the clearing house. Generally, 'those who are not bound by such usages, and have not contracted with reference to them, have no right to avail themselves of them to create an obligation against those who are parties to their adoption and bound by them *inter sese* only.''

In

National Exchange Bank of Baltimore v. *Ginn & Company*, 114 Md. 181,

a very similar situation to the one in the present case

was presented. There, also, there was a failure on the part of the drawee bank to return a certain check within the time limited by the clearing house rules. The drawee bank in the case was a member of the Baltimore Clearing House. The payee of the check, however, was not a member and therefore stood in the same position as the Ashland Bank in this case. In discussing the effect of the drawee bank's failure to comply with the clearing house rules, the court said (p. 1027):

> "As the suit is directly against the payee of the check, the situation is not affected by the rules of the clearing house through which it was presented and collected. One of these rules provides 'that errors in exchange and claims arising from the return by eleven o'clock a. m. directly between the banks which are parties hereto, and not through the clearing house,' and that 'upon request made before eleven o'clock a. m. every bank shall extend until twelve o'clock the time for returning to it checks 'not good.' When the offer was made at about a quarter to twelve o'clock to return the check under consideration, it was refused upon the ground that it was made after 11 o'clock, and that there had been no request prior to that hour for an extension of time. It is well settled that such a regulation is binding only upon the members of the Clearing House Association. Its rules are designed exclusively for their convenience and protection as among themselves, and have no effect upon the rights or liabilities of other parties. 5 Cyc. 614; *Merchants' Nat. Bank* v. *Nat. Bank of Commonwealth*, 139 Mass. 518, 2 N. E. 89; *Overman* v. *Hoboken City Bank*, 30 N. J. Law, 61. The failure of the appellant to offer to return the check and to demand repayment within the time prescribed by the rules of the clearing house would therefore not impair its claim against the payee for the restoration of the fund if its right of recovery should be found to be otherwise perfect."

In

Merchants National Bank v. *National Bank of the Commonwealth*, 139 Mass. 518,

it was said of the Boston Clearing House Association:

"To the regulations of this association the customers of the banks are not parties, and whatever effect is to be given to them as between the banks, their customers are not in a situation to claim the benefit of them, nor are they liable to be injuriously affected by them."

In

Brady on Bank Checks, (2d Ed.), at page 503,

it is said:

"While the rules enacted by the banks which comprise a clearing association are binding upon the members of the association they are not, as a general rule, permitted to have any effect upon the rights of outsiders, such as depositors and other customers of the banks. Clearing house rules are not binding on such parties, nor have they the right to claim any benefit under them, unless they contract with reference to the rules. And the rules are not binding upon member banks in their dealings with each other wherein the clearing house is not involved."

In

Michie on Banks and Banking, at page 165,

it is said:

"The rules of a clearing-house association are adopted solely for the purpose of facilitating exchanges among the banks, which are its members. They do not affect the rights and liabilities of banks and persons who are not members of the association or parties to its regulations.

* * * The regular customers of or depositors in banks, however, are not parties to the rules and regulations of a clearing house of which such banks are members, and are not, therefore, in a situation to claim the benefit of them, nor liable to be injuriously affected by them. And the rules of a clearing house as such do not govern the rights of a drawer or payee of a check who are not members of the clearing house, and do not contract with express reference to such rules."

It is to be observed in this respect that although the Ashland Bank, was, of course, a banking institution, so far

as it is concerned in this transaction it was no more and no better than an ordinary individual depositor or customer of the Federal Reserve Bank. It was the payee of three of the checks which went through the Clearing House and was the endorsee of the fourth. The checks were its own property, and not merely cashed by it for Hodgkinson or anyone else. When it deposited these four checks in the Federal Reserve Bank for collection it was in no different and no better position than that of an ordinary citizen who might have walked into any loop bank which was a member of the Clearing House and deposited in his own account similar checks for collection. It was no more a member of the Clearing House than such a citizen, and as an ordinary customer or depositor in a member bank, it is no more entitled to take advantage of the Clearing House rules than the individual depositor.

In

Schneider v. *Bank of Italy, supra:*

> "The rules of the Clearing House as such do not govern the rights of a drawee or payee of a check who are not members of the Clearing House, and do not contract with express reference to such rules."

There is no evidence whatsoever in this case to show that there was any contract between the Central Bank and the Ashland Bank "with express reference" to the rules of the Chicago Clearing House. There is nothing in the case to take it out of the general rules expressed in the authorities here cited.

IV:

There being no duty owing from Central Bank to Ashland Bank under the Clearing House rules, the only possible requirement which had to be fulfilled by Central Bank was that of giving notice of dishonor or non-payment of the checks as required by law. This was done.

102 of the Negotiable Instruments Law, codifying the common law with respect to the giving of notice of dishonor, provides:

> "Where the person giving and the person to receive notice reside in the same place, notice must be given within the following times:
>
> 1. If given at the place of business of the person to receive notice, it must be given before the close of business hours on the day following." (Ill. Revised Statutes, Chap. 98, Sec. 124.)

The Central Bank complied with this requirement. It gave notice to the Ashland Bank, through James G. Hodgkinson, its vice-president, on Monday, April 25th, immediately upon discovering the fact that payment of the checks would create an overdraft in the Corporation's Account, and, long before "the close of business hours on the day following"—in fact at 9:30 o'clock on the morning of April 26th—the actual checks were tendered back to the Ashland Bank and demand for reimbursement made.

It would seem that the giving of any such notice was not necessary to protect the rights of the Central Bank against the Ashland Bank under the circumstances of this case, for the Ashland Bank knew, or should have known (both because of the knowledge of its vice-president, James G. Hodgkinson, and because of its conduct in carrying four

of these checks as assets on its books for 28 days without attempting to cash them), that the checks were not good when it sent them through for collection. But the statutory notice was in fact given, whether necessary or not, and we contend that at 9:30 o'clock in the morning of April 26th, at the very latest, the liability of the Ashland Bank to reimburse the Central Bank became fixed.

CONCLUSION.

We submit that the main question in controversy is whether or not the conditional settlement of the Clearing House balance became a final and irrevocable payment of the checks in question upon the lapse of time fixed by the rules of the Clearing House.

The District Court and the Circuit Court of Appeals held that settlement did not become final and irrevocable because Ashland Bank was not a member of, or affiliated with, the Clearing House and was vested with no rights based upon its rules.

Those Courts also held that such being the case all that was necessary was to give notice of dishonor as provided by the Negotiable Instrument Act, which was done.

There is, therefore, no important question of Commercial Law involved; no construction of the Negotiable Instrument Law; and certainly no holding by the Circuit Court of Appeals in conflict with the weight of authority or contrary to any principles decided in the cases cited by counsel on pages 7 and 8 of the Petition.

In every case cited by counsel the law was applied to cases where the Courts specifically held that the transactions there involved constituted final and irrevocable pay-

ment. In the cases cited by us it was uniformly held that the transactions like those in the case at bar did not constitute final and irrevocable payment.

The Circuit Court of Appeals found this as a fact and we, therefore, submitted that no reasons exist why the writ should be granted.

Respectfully submitted,

DANIEL M. HEALY,
Attorney for Respondent.